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Strengthening Our Security: A New International Standard on Trade-Based Money Laundering Is Needed Now

Ross S. Delston

Stephen C. Walls

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STRENGTHENING OUR SECURITY: A NEW INTERNATIONAL STANDARD ON TRADE-BASED MONEY LAUNDERING IS NEEDED NOW

*Ross S. Delston & Stephen C. Walls**

Recently, the Financial Action Task Force (FATF) missed an opportunity to address trade-based money laundering (TBML) in its International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, known as the Forty Recommendations. In mid-February 2012, the FATF incorporated the Nine Special Recommendations on Terrorist Financing into its Forty Recommendations, yet chose not to revise the Forty Recommendations to specifically address TBML. Despite the serious and growing concern within the AML/CFT field and FATF over the widespread abuse of the international trade system to legitimize the proceeds of crime and finance terrorist activities, and the demonstrated ability of FATF to identify and respond to evolving money laundering typologies, TBML remains the only major avenue of money laundering that the FATF Forty Recommendations have not explicitly addressed. Because of the need for international action on TBML that reaches beyond banks, this article therefore proposes language for a new 41st Recommendation.

* Ross S. Delston (J.D. with honors, The George Washington University Law School, 1976) is a Certified Anti-Money Laundering Specialist (CAMS), a Washington, D.C. lawyer, and founder of GlobalAML.com LLC, a consulting firm specializing in anti-money laundering compliance. Former positions include Consulting Counsel, AML/CFT Unit, International Monetary Fund (2000–2005); Counsel and Assistant General Counsel—Assisted Acquisitions, Federal Deposit Insurance Corporation (1986–1991); and Counsel, Export-Import Bank of the U.S. (1976–1986). Stephen C. Walls (J.D. with honors, The George Washington University Law School, 2008) is a consultant in Washington, D.C., working in legislative and regulatory affairs.

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I. BACKGROUND

A. *TBML Is Widely Regarded as a Global Threat*

Estimates for the amount of money laundering through the abuse of the international trade system range from \$5 billion for Colombia alone¹ to “hundreds of billions” worldwide.² Trade-based money laundering (TBML) has been identified as a major issue in the popular press for almost twenty years,³ and has received significant attention in both the U.S. Congress and the Executive Branch since at least the late 1990s.⁴ The Financial Action Task Force (FATF) first took note of TBML as a major avenue of money laundering in 2006 in its Report entitled *Trade Based Money Laundering*.⁵

¹ U.S. DEPT. OF JUSTICE ET AL., 2007 NATIONAL MONEY LAUNDERING STRATEGY 7 app. at 57 (2007) (noting the money laundering in connection with drug trafficking in Colombia); see also Oriana Zill & Lowell Bergman, *The Black Peso Money Laundering System*, FRONTLINE, <http://www.pbs.org/wgbh/pages/frontline/shows/drugs/special/blackpeso.html> (last visited Mar. 29, 2012) (citing Fanny Kertzman, former Director of Colombian Customs).

² BUREAU OF INT'L NARCOTICS AND LAW ENFORCEMENT AFFAIRS, U.S. DEP'T OF STATE, 2 INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT 5 (2009).

³ See Oriana Zill & Lowell Bergman, *U.S. Business & Money Laundering*, FRONTLINE, <http://www.pbs.org/wgbh/pages/frontline/shows/drugs/special/us.html> (last visited Mar. 29, 2012).

⁴ See *The Black Market Peso Exchange – How U.S. Companies Are Used to Launder Money: Hearing Before the S. Caucus on Int'l Narcotics Control*, 106th Cong. (1999) [hereinafter *Black Market Peso Exchange Hearing*] (statement of Bonni Tischler, Assistant Comm'r, U.S. Customs Service.).

⁵ FINANCIAL ACTION TASK FORCE [FATF], *TRADE BASED MONEY LAUNDERING 1* (2006), available at <http://www.oecd.org/dataoecd/60/25/37038272.pdf> [hereinafter *FATF TBML REPORT*].

TBML not only threatens legitimate businesses in both the developed and developing world by undermining legal import and export operations,⁶ it also impacts one of the largest sources of income for many developing countries—customs duties.⁷ Beyond the threats to legitimate businesses, economic development and the rule of law, the U.S. State Department and U.S. Treasury Department have directly linked TBML schemes with Hezbollah,⁸ the Afghanistan drug trade,⁹ and al-Qaeda.¹⁰

Despite recognition of the widespread abuse of the international trade system to legitimize the proceeds of crime and finance terrorist activities, and the demonstrated ability of FATF to respond to evolving money laundering typologies,¹¹ TBML remains the only one of three main avenues of money laundering¹² that has not been addressed by specific language in the FATF Forty Recommendations.

B. Legally Binding U.N. Conventions on International Crime and Corruption Require Action on TBML

A December 2009 report from the U.N. Office on Drugs and Crime (UNODC), which analyzed the requirements of international instruments

⁶ See Shannon K. O’Neil, *Trade-Based Money Laundering in Mexico*, COUNCIL ON FOREIGN REL., LATIN AMERICA’S MOMENT BLOG (Apr. 13, 2011), <http://blogs.cfr.org/oneil/2011/04/13/trade-based-money-laundering-in-mexico/>; see also Tod Robberson *Traffickers Use U.S. Businesses, Cash Smuggling to Hide Billions in Profit*, SEATTLE TIMES (Nov. 19, 2010), [http://community.seattletimes.nwsouce.com/archive/?date=20011119&slug=drug trade19](http://community.seattletimes.nwsouce.com/archive/?date=20011119&slug=drug%20trade19).

⁷ See, e.g., BUREAU OF INT’L NARCOTICS AND LAW ENFORCEMENT AFFAIRS, U.S. DEP’T OF STATE, 2 INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT 88 (2007) (stating that customs duties comprise “40–50 percent of annual Bangladesh government income.”).

⁸ *Drug Investigations Lead to Treasury 311 Patriot Act Designation Against Lebanese Bank Tied to Hizballah*, U.S. DRUG ENFORCEMENT AGENCY (Feb. 10, 2011), <http://www.justice.gov/dea/pubs/pressrel/pr021011.html>.

⁹ BUREAU OF INT’L NARCOTICS AND LAW ENFORCEMENT AFFAIRS, U.S. DEP’T OF STATE, 2 INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT 5 (2008) (“[T]here is increasing realization that . . . trade goods in Dubai and elsewhere are being purchased with Afghan drug proceeds. . .”).

¹⁰ BUREAU OF INT’L NARCOTICS AND LAW ENFORCEMENT AFFAIRS, U.S. DEP’T OF STATE, 2 INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT 17 (2004) [hereinafter 2004 INCSR]; e.g., John S. Zdanowicz, *Trade Based Money Laundering and Terrorist Financing*, 5 REV. L. & ECON. 855, 867 (2009) (charting the abnormally high import prices from al-Qaeda watch list countries and the abnormally low export prices from al-Qaeda watch list countries).

¹¹ See FATF, NINE SPECIAL RECOMMENDATIONS ON TERRORIST FINANCING 2–3 (2001) [hereinafter NINE SPECIAL RECOMMENDATIONS], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/9%20Special%20Recommendations.pdf>.

¹² See FATF TBML REPORT, *supra* note 5; see also FATF, BEST PRACTICES PAPER ON TRADE BASED MONEY LAUNDERING 1 (2008) [hereinafter FATF TBML BEST PRACTICES], available at <http://www.fatf-gafi.org/dataoecd/9/28/40936081.pdf>.

addressing money laundering, found that, although neither relevant U.N. conventions nor the Forty Recommendations contain an “express obligation” to address TBML, TBML does fit under the broad obligations to combat money laundering contained in those conventions.¹³ The report states “to properly investigate money-laundering . . . the money-laundering offence needs to be defined broadly to include trade-based money-laundering schemes” and goes on to say that:

[T]he Organized Crime Convention, the Convention Against Corruption and the FATF recommendations require countries to identify, investigate and prosecute trade-based money laundering schemes, *through both the monitoring of financial transactions and sharing of relevant trade data*, [although] the provisions of the two conventions and the FATF recommendations are rather general and give Member States little guidance on how best to implement their obligations.¹⁴

C. *FATF Missed Opportunities to Address TBML in 1996, 2003 and 2012*

In February 2012, the FATF passed on its third major opportunity to address TBML in its Forty Recommendations.¹⁵ At that time, the FATF incorporated the Nine Special Recommendations on Terrorist Financing¹⁶ into the Forty Recommendations,¹⁷ yet chose not to revise the Forty Recommendations to include a new international standard on combating TBML.

Although TBML is implicitly captured by the broad range of anti-money laundering (AML) requirements in the relevant U.N. conventions,¹⁸ the FATF has not provided explicit TBML requirements for its members. Even though the FATF drafted the original Forty Recommendations in 1996, revised them in 2003, and again in 2012, and has addressed specific typologies and threats in those revisions,¹⁹ AML/CFT obligations regarding

¹³ U.N. Office on Drugs and Crime, International Cooperation to Address Money-Laundering Based on Relevant United Nations and Other Instruments, Working Paper by the Secretariat, ¶ 34, U.N. Doc. A/CONF.213/8 (Dec. 18, 2009) [hereinafter U.N. AML Report].

¹⁴ *Id.* at ¶ 36 (emphasis added).

¹⁵ See *FATF Steps up the Fight Against Money Laundering and Terrorist Financing*, FATF (Feb. 16, 2012), http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf_stepsupthefightagainstmoneylaunderingandterroristfinancing.html (describing the actions taken at the Paris meeting).

¹⁶ See *id.*; NINE SPECIAL RECOMMENDATIONS, *supra* note 11.

¹⁷ See generally FATF, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM AND PROLIFERATION: THE FATF RECOMMENDATIONS (2012) [hereinafter FORTY RECOMMENDATIONS].

¹⁸ U.N. AML Report, *supra* note 13, ¶¶ 35–37.

¹⁹ FORTY RECOMMENDATIONS, *supra* note 17.

TBML continue to lack specificity, possibly contributing to a limited global response to TBML threats to date by national and international authorities.²⁰ This brief article therefore proposes original language for a 41st Recommendation based in part on previous work by FATF and the UNODC, as well as two previous articles by the authors hereof.²¹

II. WHY EXISTING U.S. AND INTERNATIONAL APPROACHES ARE NECESSARY BUT NOT SUFFICIENT

Previous articles have discussed why it is difficult for banks and other financial institutions to effectively monitor and detect TBML,²² and why a 41st Recommendation on TBML could effectively enhance international cooperation on combating it.²³ To effectively combat TBML, all parties involved in international trade, including but not limited to exporters, importers, financial firms other than banks (e.g., factors and other non-bank financiers), and those involved in the transport of goods, defined as “traders” in the *FATF TBML Best Practices Paper*,²⁴ must implement preventive measures against money laundering. Such measures would include customer due diligence and enhanced due diligence, adequate record-keeping, dedicated AML and combating the financing of terrorism

²⁰ CLARE SULLIVAN & EVAN SMITH, AUSTL. GOV'T, AUSTL. INST. CRIMINOLOGY, TRADE-BASED MONEY LAUNDERING: RISKS AND REGULATORY RESPONSES, at iii, 20 (2011), available at <http://www.aic.gov.au/publications/current%20series/rpp/100-120/rpp115.aspx>.

²¹ See *infra* Part III; Ross Delston & Stephen Walls, *Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside the Financial Sector*, 41 CASE W. RES. J. INT'L L. 85, 92–98 (2009), reprinted in 2011 ANNUAL REVIEW OF INTERNATIONAL BANKING LAW & PRACTICE (James E. Byrne & Christopher S. Byrnes eds., 2011); see also Ross Delston, *The 41st FATF Recommendation: Why Preventive Measures Targeting Trade-Based Money Laundering Should Reach Beyond Banks*, MONEY LAUNDERING BULLETIN, March 2008, at 8 [hereinafter Delston, *Preventive Measures*]; Ross Delston, *The 41st FATF Recommendation: Why Banks Alone Cannot Prevent Trade-Based Money Laundering*, ACAMS TODAY, July–Aug. 2008, at 42 [hereinafter Delston, *Banks*].

²² See THE WOLFSBERG GROUP, THE WOLFSBERG TRADE FINANCE PRINCIPLES 1 (2009), available at [http://www.wolfsberg-principles.com/pdf/WG_Trade_Finance_Principles_Final_\(Jan_09\).pdf](http://www.wolfsberg-principles.com/pdf/WG_Trade_Finance_Principles_Final_(Jan_09).pdf) (noting that up to eighty percent of international trade takes place under so-called “Open Account” transactions between buyers and sellers, which generally provide a bank with little or no information regarding the amount of the transaction, even omitting the identities of those from whom and to whom the money is being transferred in many instances). See generally Delston, *Preventive Measures*, *supra* note 21; Delston, *Banks*, *supra* note 21.

²³ See Delston & Walls, *supra* note 21.

²⁴ FATF TBML BEST PRACTICES, *supra* note 12, at 2 (“The term trader refers to anyone who facilitates the exchange of goods and related services across national borders, international boundaries or territories. This would also include a corporation or other business unit organized and operated principally for the purpose of importing or exporting goods and services (e.g. import/export companies).”).

(CFT) compliance staff, and policies, procedures and internal controls, training, as well as reporting suspicious transactions.

A. *Enhanced Inspections Are Critical but Impractical as a Comprehensive Solution*

A recent conviction in Ireland highlights why effective action on TBML requires the participation of more entities than just financial institutions.²⁵ That case uncovered a customs fraud scheme in operation for at least five years, which was discovered only when customs officers searched a shipping container and found that the contents obviously did not correspond to the description on the bill of lading. As a result, the head of one of Ireland's largest fruit and vegetable producers and distributors was sentenced to six years in jail. A perhaps more alarming case is described in the 2004 *International Narcotics Control Strategy Report*, where discrepancies discovered only after the physical inspection of goods from Dubai unraveled a TBML scheme directly involving a member of al-Qaeda.²⁶

However, increasing on-site inspections of containers cannot be a comprehensive response, given the cost, time delays, personnel and other resources needed. Screening is enhanced by voluntary initiatives such as the Customs-Trade Partnership Against Terrorism and Container Security (C-TPAT) Initiative run by Customs and Border Protection²⁷ and statistics monitoring teams such as the Trade Transparency Units (TTUs) run by Immigration and Customs Enforcement (ICE).²⁸ However, these screening enhancement efforts do not create a sufficient deterrent to laundering money through the international trade system. Combating TBML, terrorist financing, and thereby terrorism itself, is too crucial to our nation's security to entrust to foreign customs agents or rely on the limited deterrence created by a voluntary program.

²⁵ See *Ireland Garlic Scam: Paul Begley Jailed for Six Years*, BBC (Mar. 9, 2012), <http://www.bbc.co.uk/news/world-europe-17320460> (reporting on a recent importation scam).

²⁶ See 2004 INCSR, *supra* note 10, at 22 (detailing the discovery of a TBML scheme after inspections of cosmetics and other goods being shipped through Dubai).

²⁷ See *C-TPAT: Customs-Trade Partnership Against Terrorism*, U.S. CUSTOMS & BORDER PROTECTION, http://www.cbp.gov/xp/cgov/trade/cargo_security/ctpat/ (last visited Apr. 22, 2012); *CSI: Container Security Initiative*, U.S. CUSTOMS & BORDER PROTECTION, http://www.cbp.gov/xp/cgov/trade/cargo_security/csi/ (last visited Apr. 22, 2012).

²⁸ See *Trade Transparency Unit*, U.S. IMMIGR. & CUSTOMS ENFORCEMENT, <http://www.ice.gov/trade-transparency/> (last visited April 22, 2012); see also *Homeland Security Investigations Trade Transparency Unit*, 7 CORNERSTONE REPORT, no. 3, 2011, at 3-4 (2011).

B. Trade Transparency Units Are Valuable, but Currently Cannot Generate Enough Information to Deter TBML

TTUs are excellent at detecting blatant documentary fraud and monitoring other reporting discrepancies between two cooperating customs authorities, but are not sufficient to detect documentary anomalies on all sides of the transaction. A recent case involving a TBML scheme in operation for at least ten years illustrates this difficulty.²⁹ The Angel Toy Company, based in Irvine, California, laundered Colombian and Mexican drug money through purchases of toys manufactured in and exported from China to third countries, presumably in Latin America.³⁰ The company's reputation among international criminals for laundering drug money led prosecutors to begin an investigation in 2008, and, in January 2012, two company officers pleaded guilty to charges of structuring currency transactions to avoid reporting requirements.³¹

In addition to difficulties with more complex trade transactions, such as those involving a variety of entities in four or more countries, the TTU statistics can be flawed due to fraudulent documentation by those attempting to avoid export/import fees and taxes through simple customs fraud. It would also be difficult to detect statistically the small number of terrorists using international trade to transfer profits or illicit goods, including arms and munitions, as well as weapons of mass destruction and related precursor materials.

Despite plans announced by ICE in its Fiscal Year 2013 Congressional Budget Justification to nearly double the number of TTUs with a slightly reduced overall budget,³² TTUs remain bilateral in nature, and accordingly have limited scope, and must be implemented on a country-

²⁹ Press Release, U.S. Attorney's Office Cent. Dist. Cal, Owners of Los Angeles Toy Company Sentenced to Federal Prison for Role in International Scheme to Launder Money for Drug Traffickers (Jan. 31, 2012), <http://www.justice.gov/usao/cac/Pressroom/2012/021.html> [hereinafter Owners of L.A. Toy Company Sentenced]

³⁰ Dalina Castellanos, *Toy Firm Owners get 3 Years in Money Laundering Case*, L.A. TIMES (Jan. 31, 2012), <http://latimesblogs.latimes.com/lanow/2012/01/toy-company-1.html>; see also ANGEL TOY, <http://angeltoy.com/manufacturing.asp> (last visited Apr. 22, 2012) (explaining that "[o]nce the stuffed animals are produced, they are transported from our factories to ports in Qingdao or Shanghai").

³¹ Owners of L.A. Toy Company Sentenced, *supra* note 29; see also Castellanos, *supra* note 30.

³² U.S. DEP'T OF HOMELAND SECURITY, U.S. IMMIGRATION AND CUSTOMS ENFORCEMENT SALARIES AND EXPENSES: FISCAL YEAR 2013 CONGRESSIONAL SUBMISSION, 22 (2013), available at <http://www.dhs.gov/xlibrary/assets/mgmt/dhs-congressional-budget-justification-fy2013.pdf> (stating that "in FY 2013, Domestic Investigations will . . . establish Trade Transparency Units in the Americas, Europe, Africa and Asia" to add to the six TTUs in existence, with an overall budget reduction of \$55.6 million).

by-country basis, a costly and time-consuming process.³³ New multilateral customs initiatives, such as those being negotiated under the Trans-Pacific Partnership (TPP),³⁴ could address the bilateral nature and quality of reporting issues that currently exist for TTUs, but whether such a multilateral effort will ever be effectively implemented remains to be seen.

III. THE LANGUAGE OF A 41ST RECOMMENDATION ON TBML

As discussed above, the acknowledged threat of TBML requires international anti-money laundering action that reaches beyond banks. A previous article by the authors outlined the necessary compliance programs, customer due diligence and suspicious transaction reporting that could contribute greatly to the international fight against TBML.³⁵ To build on those suggestions, a new 41st Recommendation is proposed here, using the definition of “traders” found in the *FATF TBML Best Practices Paper*³⁶ and based on the approach taken in the existing FATF Recommendations:³⁷

Recommendation 41, Trade-Based Money Laundering

Countries should have measures in place to monitor, detect and prosecute abuses of the international trade system on the basis of the Vienna and Palermo Conventions, and should ensure that one or more competent domestic authorities are authorized to supervise traders. Countries should ensure that effective, proportionate and dissuasive sanctions are available to these authorities to deal with persons who fail to comply with AML/CFT requirements under this Recommendation, fail to declare or make false declarations on customs forms or on any documentation related to the import/export of such goods, including bills of lading, invoices, warehouse receipts, and letters of credit. In cases where the goods or the underlying import/export transaction are related to terrorist financing, money laundering or predicate offences, countries should also adopt measures, including legislative measures consistent with Recommendation 4, that would enable the confiscation of such goods.

Domestic authorities should be empowered to inspect shipments with technology commensurate with the risks of money laundering and financing of terrorism, collect and review related documents, collect and analyze

³³ SULLIVAN & SMITH, *supra* note 20, at 21.

³⁴ *Outlines of the Trans-Pacific Partnership Agreement*, OFFICE OF THE U.S. TRADE REPRESENTATIVE, <http://www.ustr.gov/about-us/press-office/fact-sheets/2011/november/outlines-trans-pacific-partnership-agreement> (last visited Apr. 22, 2012) (“TPP countries also have agreed on the importance of close cooperation between authorities to ensure the effective implementation and operation of the agreement as well as other customs matters.”).

³⁵ See generally Delston & Walls, *supra* note 21.

³⁶ FATF TBML BEST PRACTICES, *supra* note 12, at 2.

³⁷ For example, Recommendation 32 on cash couriers, and Recommendations 22, 23 and 28 which apply to Designated Non-Financial Businesses and Professions, among others. FORTY RECOMMENDATIONS, *supra* note 17, at 19–21, 23–24, 25.

information gathered by domestic law enforcement authorities, and monitor trade flows on a real-time basis. Commensurate with the risks identified, countries should implement new inspection technologies relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction.

Traders should be required to implement programmes against trade-based money laundering and terrorist financing that encompass the following:

- a) Adequate internal controls, including group-wide training and information-sharing, set out in Recommendation 18;
- b) Customer due diligence and record-keeping requirements consistent with Recommendations 10, 11, 12, 15 and 17 for import and export transactions in an amount equal to or greater than the applicable designated threshold; and
- c) Report suspicious transactions as set out in Recommendations 20 and 21.

An interpretive note to this 41st Recommendation could draw heavily from red flags and other issues discussed in the 2006 FATF report entitled *Trade Based Money Laundering*,³⁸ the 2008 FATF *Best Practices Paper on Trade-Based Money Laundering*,³⁹ and the U.S. FFIEC BSA/AML Examination Manual (2010),⁴⁰ with other material from the interpretive notes for those Recommendations cited in the text of the proposed Recommendation.

IV. CONCLUSION

As noted by the Australian Institute of Criminology in its report entitled *Trade-Based Money Laundering: Risks and Responses*, a regime along the lines proposed here would precipitate a significant expansion of resources and oversight responsibilities for customs authorities.⁴¹ But we should not be surprised if a problem this large fails to offer easy solutions, nor should we be surprised that no jurisdiction is willing to be the first to implement such a regime. Yet these two factors make an international

³⁸ See FATF TBML REPORT, *supra* note 5 (discussing typologies, red-flag indicators, and capacity building); see also Delston & Walls, *supra* note 21, at 103–16 (discussing red flags and impact on TBML compliance programs).

³⁹ See FATF TBML BEST PRACTICES, *supra* note 12 (discussing capacity building and awareness raising, typologies and red-flag indicators, domestic mechanisms to link the work of relevant authorities, data protection and privacy, international co-operation, and legitimate trading activities).

⁴⁰ See *Bank Secrecy Act/Anti-Money Laundering Examination Manual*, FED. FIN. INST. EXAMINATION COUNCIL, http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm (last visited May 5, 2012).

⁴¹ SULLIVAN & SMITH, *supra* note 20, at 23.

cooperative body like FATF an ideal forum to implement an international solution to a problem that is international in scope and requires a high degree of mutual cooperation.

A 41st FATF Recommendation on TBML, including specific guidance on customer due diligence and implementing the TBML obligations identified by the UNODC,⁴² would allow the international community to mobilize against abuse of the international trade system in a manner beyond the capabilities of any single state or customs authority. Given the size and scope of the problem, the difficulty in concluding a binding, TBML-specific international convention, and the widespread recognition of the risks entailed, the time is now for a 41st FATF Recommendation on trade-based money laundering.

⁴² U.N. AML Report, *supra* note 13, ¶ 36 (identifying obligations such as identifying, investigating, and prosecuting trade-based money-laundering offenses).